89-1587

No. 89-_____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

REYNOLDS METALS COMPANY,
Petitioner,

v.

JAMES M. SIZEMORE, JR.,
as Commissioner of Revenue of the State of Alabama,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ALABAMA

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QUESTIONS PRESENTED

For the privilege of doing business within the State, Alabama imposes annual franchise taxes on both foreign and domestic corporations. The franchise tax for foreign corporations, however, is different from the franchise tax for domestic corporations. The foreign franchise tax is based on the amount of capital actually employed in the State. The domestic franchise tax, on the other hand, is based upon the arbitrarily established par value of outstanding stock. For similarly situated foreign and domestic corporations, the amount of capital actually employed in the State is almost invariably far greater than the amount of par value of outstanding stock. As a result, the tax burden imposed on foreign corporations for the privilege of doing business in the State is grossly disproportionate to the tax burden imposed on similarly situated domestic corporations for the same privilege. No one, including the State, disputes this fact. In 1983, for example, an out-of-state corporation's franchise tax was typically more than 600% greater than the franchise tax paid by a similarly situated in-state corporation.

The questions presented are:

1. Whether a corporate franchise tax that discriminates against out-of-state corporations, on its face and as applied, can survive Commerce Clause scrutiny because, according to the court below,

   (a) the Commerce Clause forbids only taxes that "invidiously" discriminate against interstate commerce, and

   (b) the Commerce Clause permits some discrimination against interstate commerce.

Questions Presented Continued

2. Whether a corporate franchise tax that discriminates against out-of-state corporations, on its face and as applied, can survive Commerce Clause scrutiny because, according to the court below, the discrimination is diminished, but not eliminated, by a purportedly "complementary" *ad valorem* tax imposed on shareholders of in-state corporations.

3. Whether a discriminatory corporate franchise tax that is otherwise invalid under the Equal Protection Clause can be justified on the ground that the historical purpose of the tax, which was enacted in 1915, was to avoid discrimination against out-of-state corporations.

PARTIES TO THE PROCEEDINGS BELOW

The following were parties in the proceedings below:

Reynolds Metals Company	Plaintiff-Appellee
General Motors Corporation	Plaintiff-Appellee
GMAC Leasing Corporation	Plaintiff-Appellee
General Motors Acceptance Corporation	Plaintiff-Appellee
James C. White, Sr., as Commissioner of Revenue of the State of Alabama*	Defendant-Appellant
Department of Revenue of the State of Alabama	Defendant-Appellant

STATEMENT REQUIRED BY RULE 29.1

Petitioner, Reynolds Metals Company, is a corporation whose stock is publicly traded on the New York Stock Exchange and is not a subsidiary of any other corporation. The list of Reynolds' subsidiaries required by Rule 29.1 is included in the Appendix at pages 66a-67a.

*James C. White, Sr. was Commissioner of Revenue at the time the action below was commenced. The present Commissioner, James M. Sizemore, Jr., is the Respondent before this Court.

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PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ALABAMA

Petitioner, Reynolds Metals Company, respectfully requests this Court to issue a writ of certiorari to review the judgment of the Supreme Court of Alabama entered in this action on December 21, 1989. In addition, petitioner respectfully requests this Court to reverse the judgment of the Supreme Court of Alabama and to remand the case for further proceedings by the court below to determine the remedy to which petitioner is entitled.

OPINION BELOW

The opinion of the Supreme Court of Alabama at issue has not yet been reported. The court's opinion is reproduced in the Appendix at pages 1a-32a.

The opinion of the Alabama Court of Civil Appeals also has not yet been reported. That court's opinion is reproduced in the Appendix at pages 35a-44a.

The Final Judgment and the Memorandum Opinion of the Circuit Court of Montgomery County, Alabama are not reported. That court's Final Judgment and Memorandum Opinion are reproduced in the Appendix at pages 46a-56a and 59a-62a, respectively.

JURISDICTION

The judgment sought to be reviewed was dated and entered on December 21, 1989. Petitioner timely filed an application for rehearing, which application was overruled on January 12, 1990. This petition for a writ of certiorari is being filed within 90 days after the entry of the order of the Supreme Court of Alabama denying rehearing. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause of the Constitution of the United States, art. I, § 8, cl. 3, provides: "The Congress shall have Power to regulate Commerce with foreign Nations, and among the several States, and with Indian Tribes."

The Equal Protection Clause of the Constitution of the United States, amend. XIV, § 1 provides: "[N]or shall any State . . . deny to any person within its jurisdiction the equal protection of the laws."

Relevant portions of the Alabama Constitution and the Code of Alabama are set forth in the Appendix at pages 68a-75a.

STATEMENT OF THE CASE

The tax at issue in this case, which now imposes a dramatically disproportionate burden on out-of-state corporations, had its origins in an effort to avoid discrimination against such corporations. Through the passage of time and changes in business practice, what was once a benign levy was transformed into an instrument of discrimination.

A. Historical Background.

The Alabama Constitution of 1901 authorized the Alabama legislature to enact a franchise tax on foreign corporations based upon "the actual amount of capital employed" in the State and a franchise tax on domestic corporations "in proportion to the amount of capital stock." Ala. Const. §§ 232, 229 (1901). In 1903, Alabama adopted a franchise tax applicable only to foreign corporations. Ala. Code §§ 2391-2400 (1907). The Supreme Court of Alabama sustained the tax in *Southern Ry.* v. *Greene*, 160 Ala. 396, 49 So. 404 (1909), but this Court reversed, 216 U.S. 400 (1910), holding that the tax violated the Equal Protection Clause because it arbitrarily discriminated against out-of-state corporations.

The Alabama legislature responded by enacting a franchise tax on both domestic and foreign corporations. Ala. Acts 1915, Act. No. 464. The domestic franchise tax was based upon the corporation's "paid up capital stock" (par value). The foreign franchise tax, on the other hand, was based upon "the actual amount of capital actually employed in this State." *Id.*

In 1918, the Supreme Court of Alabama rejected a foreign corporation's claim that the use of one tax base for the foreign franchise tax and a different tax base for

domestic franchise tax violated the Equal Protection Clause. *Louisville & N.R.R.* v. *State*, 201 Ala. 317, 78 So. 93 (1918), *error dismissed*, 248 U.S. 533 (1918). The court observed that the levy "did not operate as an arbitrary discrimination against foreign corporations" and that the difference between the two taxes "was made for the sole purpose of avoiding a discrimination against foreign corporations." 201 Ala. at 318, 78 So. at 94.

At the time of the court's decision, the 1915 statute's directives to tax "paid up capital stock" and "capital actually employed" were considered equitable. "[U]nder normal conditions, that is, in dealing with corporations ordinarily capitalized and conducted, the burden will fall upon them equally and equitably." 201 Ala. at 320, 78 So. at 96. A corporation's par value was substantially equivalent to its "actual amount of capital employed." The use of different bases for determining the franchise taxes for foreign and domestic corporations did not, therefore, create any systematic discrimination against foreign corporations. The tax did not violate the Constitution, the Alabama Supreme Court held, because "[t]here can be little or no discrimination between domestic and foreign corporations in the general and ordinary operation of our statute." 201 Ala. at 318, 78 So. at 94.

As time passed and practices changed, this ceased to be the case for two principal reasons. First, par value lost its significance as a meaningful measure of a corporation's capital. "Legal capital is entirely a legal invention, highly particularized in its meaning, historical in reference, and not relatable in any way to the ongoing economic condition of the enterprise." B. Manning, *A Complete Textbook on Legal Capital* 24 (2d ed. 1981). Second, over the years the statutory definition of "capital"—the starting point for computing the foreign franchise tax—has been dramat-

ically expanded to include many items (see below) not historically thought of as capital. As a result of these changes, the foreign franchise tax based on actual capital employed in the State became much more burdensome than the domestic franchise tax based on par value.

B. The Operation Of The Foreign And Domestic Franchise Taxes.

The foreign franchise tax is $3 for every $1,000 of the "actual amount of its capital employed" in the State, with a $25 minimum. Ala. Code § 40-14-41 (1975). "Capital" for this purpose is defined by statute to include not only the par value of the foreign corporation's outstanding stock—which alone is the measure of the domestic corporation's tax base—but also its surplus and retained earnings, long-term liabilities, virtually all related-party indebtedness, and an adjustment to add back accelerated depreciation. *Id.* Capital employed in Alabama is determined by apportioning total capital to Alabama on the basis of a three-factor formula (property, payroll, sales).

During the years at issue, the domestic franchise tax was $3 for every $1,000 of capital stock, with a $25 minimum. Ala. Code § 40-14-40 (1975); App. 69a. Although not defined by statute, the term "capital stock" for this purpose has been judicially interpreted to mean the aggregate par value of the domestic corporation's outstanding stock. App. 6a-9a. If the stock is no-par, the rate is applied to the aggregate stated value of the outstanding stock. Domestic corporations can arbitrarily set and reduce the par value of their stock. *See*, Ala. Code §§ 10-2A-32 (1975) (shares may have any par value or no par value); 10-2A-41 (1975) (official commentary recognizing that Alabama no longer has minimum capital requirements).

Under the statutory scheme, foreign, but not domestic, corporations incur increased franchise tax liabilities as they earn and retain income[1] or increase indebtedness. Moreover, domestic corporations can unilaterally lower their franchise taxes by reducing par value. Such manipulation has occurred. (Record 309-10, 401). Changes in par value for foreign corporations, however, have no effect on the foreign franchise tax base, as the State has admitted. (R. 312).

C. The Department Of Revenue's Study Documenting Discrimination.

By the early 1980's, discriminatory impact was plainly evident. During 1982 and 1983, the years involved in this action, the State collected $94 million in foreign franchise taxes based on 28,792 foreign franchise tax returns, and less than $10 million based on 81,698 domestic franchise returns. (R.364).

The Alabama Department of Revenue became concerned about the discrimination against foreign corporations and, in 1983, it conducted a study of the comparative burdens of the foreign and domestic franchise taxes. (R. 365-74). The Department first analyzed the 1983 financial statements of domestic corporations to determine their "total capital employed"—the foreign franchise tax base. The Department then applied the foreign franchise tax

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[1] Ernest J. Broadhead, Chief of the Alabama Department of Revenue Franchise Tax Division, admitted in his deposition that a $200 million retained profit would increase the foreign franchise tax base by $200 million, but would not affect the domestic franchise tax base. (R. 345).

rate to determine the amount of foreign franchise tax that domestic corporations would pay.[2]

The Department's study showed that domestic corporations employed approximately 45% of the total capital employed in Alabama by both domestic and foreign corporations. App. 24a. Yet, for 1983, domestic corporations paid less than $5 million out of the total $52 million in domestic and foreign franchise taxes. (R. 364). Thus, despite employing 45% of the total capital employed by all corporations in Alabama, domestic corporations paid less than 10% of the total franchise tax burden.

ALABAMA DEPARTMENT OF REVENUE STUDY AND IMPLICATIONS (1983 DATA)

	Domestic Corporations	Foreign Corporations
% of Capital Employed[3]	45%	55%
Franchise Taxes[4]	$5 million	$47 million
% of Franchise Taxes[4]	10%	90%
Tax/$1,000 Capital Employed[5]	39 cents	$3.00

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[2] While the Department lacked data to permit it to apportion the capital of domestic corporations to Alabama, the Department assumed that domestic corporations employed all of their capital in the State. In his deposition, Chief Broadhead, who conducted the study, elaborated in detail on the manner and method in which the study was conducted. He agreed that this was a "fair assumption" and that the "assumption would have minor impact on the findings." (R. 324-26). Indeed, equality between domestic and foreign corporations would be achieved only if domestic corporations employed 89% of their capital outside of Alabama.

[3] App. 24a; R. 607-608.

[4] R. 364.

[5] In his affidavit, which was quoted in its entirety and heavily relied upon by the Supreme Court of Alabama, (App. 21a-25a) Chief Broadhead stated that if domestic corporations had been taxed on the same basis as foreign corporations (*i.e.*, at the rate of $3 per $1000 of capital

The Department then estimated the results of taxing domestic and foreign corporations at equal rates on the "capital employed" basis used for the foreign franchise tax. Based on capital employed, Reynolds calculates the effective foreign franchise rate was more than six times higher than the effective domestic rate. (See table above.) Applying the foreign franchise "capital employed" basis in 1983 to domestic corporations resulted in an increase in the domestic tax revenues from $5 million to $38 million—a $33 million or 667% increase. (R. 370). Utilizing an equally applied rate of $2 per $1,000 of capital employed produced approximately the same total revenues generated by the existing disparate taxes. (R. 372).

D. The Proposal And Rejection Of Remedial Legislation.

As a result of the study, the Department proposed legislation to tax both domestic and foreign corporations at the rate of $3 per $1,000 of capital actually employed in the State, with a $100 minimum tax. (R. 441-55). The legislature refused to enact this equal taxation proposal. (R. 337-38).

In 1983, the Alabama legislature did increase the domestic franchise tax to $10 per $1,000 of capital stock (par value), with a $50 minimum tax; but this did not

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actually employed in Alabama) the average domestic corporation would have paid franchise tax of $991.70 in 1983. This indicates that the 38,772 domestic corporations included in Chief Broadhead's study employed approximately $12.8 billion of capital in Alabama ($991.70 x 38,772/.003 = $12,816,730,000). The actual franchise tax paid by domestic corporations in 1983 was $5,041,752. Thus, domestic corporations paid approximately 39 cents in franchise tax for each $1000 of capital employed in Alabama ($5,041,752/$12,816,730,000 x $1000 = $0.39). In contrast, foreign corporations paid franchise tax at the statutory rate of $3 per $1000 of capital employed in Alabama.

eliminate the disparity between the domestic and foreign franchise tax burdens. (R. 338).[6]

E. Proceedings Below.

Petitioner, Reynolds Metals Company, is a Delaware corporation with its principal place of business in Richmond, Virginia. Reynolds, a major aluminum producer, does business in Alabama, and in 36 other states, as a foreign corporation. In 1982 and 1983, Reynolds paid approximately $1.2 million in Alabama foreign franchise taxes. (R. 2, 3, 12). In 1984, Reynolds filed timely applications for refunds with the Department; the applications were denied. (R. 3, 4, 12).

On July 28, 1986, Reynolds filed a petition for a writ of mandamus in the Circuit Court of Montgomery County, Alabama, seeking an order requiring the Commissioner of Revenue to certify Reynolds' entitlement to foreign corporation franchise tax refunds for the tax years 1982 and 1983. App. 76a-84a. The petition alleged that Alabama's foreign franchise tax discriminates in violation of the Commerce Clause and the Equal Protection Clause. General Motors Corporation and certain of its subsidiaries subsequently brought similar actions, which were consolidated with Reynolds' case. (R. 26-66, 102-52,

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[6] This increase, together with an addition of 3,200 domestic franchise tax returns, increased the domestic franchise tax collected in 1984 to just under $14.7 million (from just over $5 million in 1983). At the same time, the foreign franchise tax, which remained unchanged, increased to $49.6 million (from just under $47 million), with an addition of 446 foreign franchise tax returns. Thus, the burden on domestic corporations as a percentage of the total franchise tax burden increased from less than 10% in 1983 to just under 23% in 1984 —still far short of domestic corporations' proportionate burden based on the proportion of total capital employed in the State. (R. 364).

159-68, 176-85, 192-208). Those actions asserted the same constitutional claims as Reynolds'; but sought different types of relief for different years. (R. 24-25).

During discovery, Reynolds repeatedly requested the State to identify any legitimate purpose justifying the disproportionate burden of the foreign franchise tax. (R. 295, 424-25, 619). Only one such purpose was advanced. In his disposition, Chief Broadhead initially stated he thought that it costs perhaps $200,000 per year more to administer the foreign franchise tax than it costs to administer the domestic franchise tax. (R. 622). On further questioning, however, he acknowledged enforcement to be, in fact, easier and less expensive against foreign corporations than against domestic corporations. (R. 625).

The cases were submitted to the trial court and decided on cross-motions for summary judgment. On July 7, 1989, the trial court entered a Partial Judgment and Memorandum Opinion holding that the Alabama foreign franchise tax discriminates against foreign corporations in violation of the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution. App. 57a-62a. The court explained its decision as follows:

> The Court finds that Section 40-14-41 facially discriminates against foreign corporations in favor of domestic corporations and likewise is discriminatory in its application. The statistics and figures quoted in the taxpayers' briefs, as supported by the discovery documents, clearly show a gross disparity of franchise taxes paid by a foreign corporation when compared to domestic corporations. In 1982 and 1983, Alabama collected almost $94,000,000 in franchise tax from approximately 29,000 foreign corporations; however, Alabama collected less than $10,000,000 in franchise tax from the 82,000 domestic corporations

> filing franchise tax returns for 1982 and 1983. The Court has considered the other facts and figures set out in the taxpayers' briefs, finds them supported by the evidence, and adopts them as a basis for its holding in this case. Significantly, the Department of Revenue (Department) has failed to advance any legitimate state purpose for this discrimination. Therefore, the court is compelled to find that Section 40-14-41 discriminates against foreign corporations qualified to do business in Alabama and is unconstitutional. App. 60a-61a.

Having found the foreign franchise tax to clearly violate the Equal Protection Clause, the trial court declined to consider Reynolds' Commerce Clause arguments. App. 60a.[7]

On November 28, 1989, the Alabama Court of Civil Appeals unanimously affirmed the trial court's judgment, holding that the foreign franchise tax violates the Equal Protection Clause. App. 35a-44a. The court summed up its decision stating:

> We have little difficulty in finding that the franchise tax against foreign corporations is clearly a discriminatory tax with no legitimate state purpose. The State has advanced none, nor can we conceive of any legitimate state purpose which would be served by applying the grossly disproportionate tax. Therefore, we affirm the trial court's partial summary judg-

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[7] On August 14, 1989, the trial court entered its Final Judgment holding that Reynolds' tax payments pursuant to the foreign franchise tax statute, which it had held unconstitutional, were made under mistake of law for purposes of the refund statute and that Reynolds had complied with the procedural requirements of the refund statute, Ala. Code § 40-1-34 (1975). (App. 46a-49a). Nevertheless, citing *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971), the court concluded that its decision should apply only prospectively from the date of its decision.

ment order of July 7, 1989, which declared § 40-14-41, Ala. Code 1975, unconstitutional. App. 39a.

Like the trial court, the Court of Civil Appeals declined to address Reynolds' Commerce Clause arguments, and decided that the trial court's decision should apply prospectively only. App. 39a-44a.

On November 30, 1989, two days after the Civil Appeals Court's decision, Governor Hunt of Alabama called a special session of the legislature to adopt a replacement for the foreign franchise tax. The Governor proposed replacing the foreign franchise tax and the domestic franchise tax with a single franchise tax applicable to both domestic and foreign corporations and based on capital actually employed in Alabama, equalizing the tax burdens on domestic and foreign corporations. Because the imposition of a tax on domestic corporations based on capital employed in the State raised questions under the Alabama Constitution, the Governor requested the Supreme Court of Alabama to render an advisory opinion on the question whether his proposal would require amendment of the Alabama Constitution.

On December 5, 1989, the Supreme Court of Alabama, *sua sponte*, issued a writ of certiorari to the Court of Civil Appeals. The parties were ordered to file any briefs by December 8, 1989 and oral argument was set for December 11, 1989. App. 33a. On December 21, 1989, the Supreme Court of Alabama reversed the decision of the Court of Civil Appeals and rendered a decision holding that the foreign franchise tax does not violate either the Commerce Clause or the Equal Protection Clause. App. 1a-32a.

On December 21, 1989, the same day it issued its opinion in this case, the Supreme Court of Alabama issued

Advisory Opinion No. 330 to Governor Hunt, opining that section 229 of the Alabama Constitution makes no provision for allocation or apportionment of the domestic franchise tax base. App. 85a-89a.

F. The Alabama Supreme Court's Opinion.

The Alabama Supreme Court bottomed its Commerce Clause analysis on the premise that the Commerce Clause standards and Equal Protection Clause standards are virtually the same, and that only invidious discrimination would offend the Commerce Clause:

> While there are certain differences between this [Commerce Clause] test and the test for application of the Equal Protection Clause, they are sufficiently similar that the bulk of our analysis will not treat them separately.
>
> The question, as we see it, is whether the franchise tax on foreign corporations *invidiously* discriminates against them by imposing a grossly disproportionate tax on them for no other reason than to provide a competitive advantage to domestic corporations. (emphasis in original) App. 18a.

In applying this test, the court considered factors which, in its view, reduced the discrimination against out-of-state corporations to what it considered a constitutionally tolerable level.

The court first invoked this Court's doctrine that a discriminatory tax may survive Commerce Clause scrutiny if the State has imposed a "complementary" exaction on a "substantially equivalent event" that eliminates the discrimination. The court found that an Alabama personal property tax on the shares of domestic corporations was designed to complement the foreign franchise tax. App. 25a-26a. The court so held even though the domestic

shares tax is a property tax imposed on shareholders, whereas the foreign franchise tax is an excise tax imposed on corporations for the privilege of doing business in the State.

In addition, the court failed to note that the domestic shares tax was enacted some four-plus decades prior to the enactment of the foreign franchise tax. On the assumption that the 1867 domestic shares tax complemented the 1915 foreign franchise tax, the court aggregated the domestic shares tax with the domestic franchise tax for purposes of comparison with the foreign franchise tax. Although substantial discrimination against foreign corporations remains even after accounting for the burden of the domestic shares tax, the court dismissed the discrimination on the ground that there was "no discrimination of constitutional significance." App. 28a.

In rejecting Reynolds' Commerce Clause claim, the court also embraced an argument advanced by *amicus curiae* that, considering the foreign and domestic franchise taxes and the domestic shares tax, certain types of business (*i.e.*, those employing primarily tangible assets) would find it advantageous to incorporate in Alabama, while other types of business (*i.e.*, those employing primarily intangibles) would find it advantageous to conduct business through a foreign corporation. The court accepted this proposition as justification for the discrimination, reasoning that, because the combined effect of Alabama tax laws in some situations favors doing business in the state as a foreign corporation, the general discrimination of the foreign franchise tax against foreign corporations cannot violate the Commerce Clause.

With respect to Reynolds' equal protection claim, which the court did not clearly distinguish from Reynolds' Commerce Clause claim, the court declared:

> Even assuming that the lack of uniformity in taxes on domestic and foreign corporations rose to a level of discrimination that would invoke equal protection or commerce clause analysis, we would hold that [the tax] does not violate those provisions . . . App. 28a.

The court offered the following reasons for its conclusion:

> (a) There is no invidious discrimination or hostile purpose because the tax was enacted to avoid discrimination;
>
> (b) With the domestic shares tax factored in, the burdens are not so disproportionate that it can be said the taxing method is not rationally related to the purpose of enacting a non-discriminatory tax;
>
> (c) Reynolds had not presented sufficient evidence to negate a number of legitimate purposes that were "apparent" to the court: the mandate of the Alabama Constitution, ease of regulation and enforcement, differences in utilization of natural resources, differences in employment of state services, and utilization of state services.

Within hours after the Alabama Supreme Court issued its decision, the legislature ended its special session without taking any action to modify either the foreign or domestic franchise taxes. Reynolds filed a timely application for rehearing on January 4, 1990, which was overruled January 12, 1990. App. 63a. This petition followed.

REASONS FOR GRANTING THE WRIT

The Supreme Court of Alabama has upheld a franchise tax that is grossly discriminatory against foreign corporations, both facially and in practical effect. The court below accomplished this startling result by what amounts to a *de facto* revolt against this Court's Commerce Clause teachings and by creating a set of novel and exceedingly dangerous Commerce Clause principles:

(a) The standards for adjudicating the validity of discriminatory taxes are the same under the Commerce and Equal Protection Clauses;

(b) Only invidious discrimination offends the Commerce Clause;

(c) The Commerce Clause permits some discrimination against interstate commerce;

(d) A discriminatory franchise tax on out-of-state corporations may, under this Court's Complementary Tax Doctrine, be "complemented" or offset by a personal property tax on shareholders of in-state corporations, despite the lack of "substantial equivalence" between the two levies;

(e) Substantial discrimination against interstate commerce can be discrimination without "constitutional significance."

The crux of the court below's equal protection analysis was equally novel and dangerous:

(a) An original purpose to avoid discrimination immunizes from equal protection attack a tax that in time becomes highly discriminatory;

(b) Whan a state tax on out-of-state corporations whose purpose is to avoid discrimination becomes highly discriminatory, state courts may speculatively create new legitimizing purposes *ex post facto* and without support in the record.

This revolutionary decision should not be left undisturbed. It is in direct conflict with the decisions of this Court and has enormous potential ramifications. It eviscerates Commerce Clause protections against discriminatory taxation of interstate commerce at a time when, because of the loss of federal revenue sharing funds, the States are under extraordinary pressure to generate additional tax revenue without raising the taxes

of their citizens. For these reasons, the Court should hear this case.

I. THE DECISION BY THE COURT BELOW IS IN DIRECT CONFLICT WITH DECISIONS OF THIS COURT WHICH SET FORTH THE STANDARDS FOR DETERMINING WHETHER A TAX DISCRIMINATES IN VIOLATION OF THE COMMERCE CLAUSE.

A. The Commerce Clause Forbids All State Tax Discrimination Against Interstate Commerce—Whether Or Not The Discrimination Is "Invidious."

In upholding the foreign franchise tax against Reynolds' Commerce Clause challenge, the Supreme Court of Alabama admitted that the tax discriminates against foreign corporations. App. 28a. Nevertheless, the court declared that:

> The question, as we see it, is whether the franchise tax on foreign corporations *invidiously* discriminates against them by imposing a grossly disproportionate tax on them for no other reason than to provide a competitive advantage to domestic corporations. We emphasize the term "invidiously" because the tax will be sustained if its classifications are related to a legitimate state purpose and because, in enacting taxing statutes, legislatures are not required to reach equality with mathematical precision. App. 18a (emphasis in original).

The decisions of this Court cited in support of this statement, however, include only cases interpreting the Equal Protection Clause. *See, e.g., Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522 (1959) (cited by the court below at App. 19a); *Lehnhausen* v. *Lake Shore Auto Parts Co.*, 410 U.S. 356 (1973) (cited by the court below at App. 19a). Cases interpreting the Commerce Clause are totally absent. There is, of course, good reason for this absence. In equal protection cases, state tax discrimination will, in

fact, withstand constitutional scrutiny if it is not "invidious nor palpably arbitrary." *Allied Stores*, 358 U.S. at 530. *See also Lehnhausen*, 410 U.S. at 360. As this Court has declared, "it is only the invidious discrimination, the wholly arbitrary act, which cannot stand consistently with the Fourteenth Amendment." *New Orleans* v. *Dukes*, 427 U.S. 297, 303-304 (1976). To suggest, however, that this "invidious" discrimination standard likewise applies to discrimination against interstate commerce reflects a fundamental misunderstanding of this Court's Commerce Clause doctrine. For this Court has made it perfectly clear that the Commerce Clause forbids *all* state tax discrimination against interstate commerce, whether "invidious" or otherwise.

1. *The Commerce Clause Forbids All Taxes That Effectively Discriminate Against Interstate Commerce Whether Or Not The Discrimination Is Intentional.* The court below clearly erred in holding that the Commerce Clause is only offended by taxes which discriminate "for no other purpose than to provide a competitive advantage to domestic corporations." In evaluating a claim that a state tax discriminates against interstate commerce, this Court has made it clear that the inquiry must focus on the "actual effect" of the tax on out-of-state as compared to in-state interests, whatever the legislative intent underlying the tax. "In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce." *Best & Co.* v. *Maxwell*, 311 U.S. 454, 455-56 (1940). Thus, "[t]he principal focus of inquiry must be the practical operation of the statute, since the validity of state laws must be judged chiefly in terms of their probable effects." *Lewis* v. *BT Inv. Managers, Inc.*, 447 U.S. 27, 37 (1980).

Because it is the effect of the state taxing scheme on local versus out-of-state interests that is the touchstone of constitutionality under the Commerce Clause, it makes no difference for Commerce Clause purposes whether the state legislature's effective discrimination against out-of-state interests is intentional. For example, in *Halliburton Oil Well Cementing Co.* v. *Reily*, 373 U.S. 64 (1973), this Court struck down a use tax that discriminated against out-of-state assemblers of oil well cementing equipment. The Court observed that it was constitutionally irrelevant that the state legislature may not have intended to discriminate against interstate commerce: "While the inequality in question may have been an accident of statutory drafting, it does in fact strike at a significant segment of economic activity and carries economic effects of a type proscribed by many previous cases." *Id.* at 72.

Hence, the fact that the discrimination may not have been deliberate does not cure the constitutional infirmity in the tax because "equality for the purposes of competition and the flow of commerce is measured in dollars and cents, not legal abstractions." *Id.* at 70. Other decisions of this Court likewise hold that allegedly benign or nondiscriminatory intent is not a constitutionally sufficient antidote to a state tax which has a discriminatory effect. *See, e.g., Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263, 273 (1984) ("it is irrelevant to the Commerce Clause inquiry that the motivation of the legislature was the desire to aid the makers of the locally produced beverage rather than to harm out-of-state producers").

2. *The Commerce Clause Does Not Tolerate Some Minimum Level of Discrimination Against Interstate Commerce.* Even after improperly considering the combined effects of the domestic franchise tax and the domestic shares tax (see pages 21-24, *infra*), the court below was

still unable to explain away all of the discrimination against interstate commerce and substantial discrimination remained (approximately 43% in 1985, 18% in 1984, no data for 1982, 1983)[8]. Rather than admit that the foreign franchise tax failed this Court's "strict rule of equality" (*Halliburton Oil Well Cementing Co.* v. *Reily*, 373 U.S. 64, 73 (1963)) in Commerce Clause cases, however, the court below concluded, without citing any authority, that "no discrimination of *constitutional significance* exists." App. 28a (emphasis added). This Court rejected that conclusion nine years ago in *Maryland* v. *Louisiana*, 451 U.S. 725 (1981), where it stated:

> It may be true that further hearings would be required to provide a precise determination of the extent of the discrimination in this case, but this is an insufficient reason for not now declaring the Tax unconstitutional and eliminating the discrimination.

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[8]

	Comparative Average Domestic Corporation[a]	Average Foreign Corporation[b]	Foreign Franchise Tax Percentage Greater Than Combined Domestic Franchise and Shares Taxes[c]
1985	$2,583.45	$3,685.40	42.7%
1984	$2,815.87	$3,323.08	18.0%

[a] For the purpose of its Complementary Tax Doctrine analysis, the court below (i) added the average domestic franchise tax and the average domestic shares tax, then (ii) multiplied the total by 4.5 based on its conclusion that the average foreign corporation employs approximately 4.5 times as much capital as the average domestic corporation. App. 21a-24a.

[b] App. 23a-24a.

[c] Percentages were calculated by (i) subtracting Comparative Average Domestic from Average Foreign and (ii) dividing the remainder by Comparative Average Domestic.

> *We need not know how unequal the Tax is before concluding that it unconstitutionally discriminates.*

451 U.S. at 759-60 (emphasis added). *See also Westinghouse Elec. Corp.* v. *Tully*, 466 U.S. 388, 397, 405 (1984) (even an "indirect" or "slight" disparity is forbidden under the Commerce Clause).

3. *Violation Of The Commerce Clause Does Not Require Discrimination Against All Those Engaging In Interstate Commerce.* The court below also held that the foreign tax franchise tax does not violate the Commerce Clause because it does not discriminate against all foreign corporations. According to the court below, corporations which employ primarily intangible property may, indeed, prefer to operate in Alabama as foreign corporations. But this holding too conflicts with the Commerce Clause decisions of this Court. This Court's decisions make it quite clear that discrimination that harms some interstate business violates the Commerce Clause, even though other interstate business may be unaffected or even favored. *American Trucking Associations, Inc.* v. *Scheiner*, 483 U.S. 266, 286 (1987) ("Nor is the axle tax saved because some out-of-state carriers which accrue high mileage in Pennsylvania pay the axle tax at a lower per-mile rate than some Pennsylvania based carriers"). *See also New Energy Co. of Indiana* v. *Limbach*, 486 U.S. 269, 276 (1988) ("Our cases, however, indicate that where discrimination is patent, as it is here, neither a widespread advantage to in-state interests nor a widespread disadvantage to out-of-state competitors need be shown").

B. Alabama's Facially Discriminatory Tax Cannot Be Justified Under This Court's Complementary Tax Doctrine.

In certain narrow and well-defined circumstances, this Court has sustained taxes that discriminated on their face

against interstate commerce on the ground that the taxes "complemented" or "compensated" for equivalent levies imposed exclusively upon in-state taxpayers or transactions. *See, e.g., Henneford* v. *Silas Mason Co.*, 300 U.S. 577 (1937) (use tax on out-of-state purchases complements sales tax on in-state purchases). At the same time, however, the Court has recognized that the ban against discrimination would be totally ineffective if a State could defend a tax imposed solely on out-of-state businesses merely by pointing generally in the direction of some other tax or taxes paid only by in-state businesses. *See, e.g., Armco, Inc.* v. *Hardesty*, 467 U.S. 638 (1984).

Accordingly, to ensure effective protection of interstate commerce, the Court has strictly limited the scope of the Complementary Tax Doctrine. For the Doctrine to apply, the taxes must be imposed on "substantially equivalent event[s]." *Armco, Inc.* v. *Hardesty*, 467 U.S. at 643; *Maryland* v. *Louisiana*, 451 U.S. 725, 759 (1981). Furthermore, the taxes taken together must result in equal tax burdens. "The common thread running through the cases upholding compensatory taxes is the equality of treatment between local and interstate commerce." *Maryland* v. *Louisiana*, 451 U.S. at 759.

The Alabama Supreme Court's effort to justify the State's facially discriminatory tax on foreign corporations under the Complementary Tax Doctrine ignores these fundamental principles in three respects. First, the levy on shares of domestic corporations, which the court serves up as a "complementary" tax, does not even remotely fit this Court's description of such a tax. In striking contrast to those taxes that this Court has characterized as complementary, the shares tax and the franchise tax bear scant resemblance to one another. The shares tax is an *ad valorem* property tax, whereas the

franchise tax is an excise tax for the privilege of doing business in the State. The shares tax is assessed against the shareholder, whereas the franchise tax is assessed against the corporation. *Compare* Ala. Code § 40-14-70 (1975) *with* Ala. Code § 40-14-41 (1975). Not only are the levies imposed on different events, they are imposed on different taxpayers. This is not the stuff of "substantial equivalence."

Second, unlike taxes that this Court has viewed as complementary in the past, the shares tax was not "intended to effect equality." *Henneford* v. *Silas Mason Co.*, 300 U.S. at 585. The shares tax traces its lineage back to 1867, Ala. Code, T. 7, Ch. 3, art. 2, § 434 (1867) nearly half a century before the franchise tax was enacted. *See* page 3, *supra*. Hence, it could not possibly have been designed to complement a nonexistent tax. Moreover, it is quite clear that, as an original matter, it was the *franchise* tax on domestic corporations that was designed to complement the franchise tax on foreign corporations.[9] (See pages 3-4, *supra*). Changes in circumstances, however, have destroyed the historical equivalence between these two levies. (See pages 4-5, *supra*).

Third, even if the shares tax were viewed as "substantially equivalent" to the foreign franchise tax, it would fail to satisfy the Complementary Tax Doctrine because it does not create "equality of treatment between local and interstate commerce." *Henneford*, *supra*. The record is undisputed that discrimination against foreign corporations remains even when the shares tax is included in the

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[9] If the domestic shares tax has a complement, it would appear to be the general *ad valorem* tax imposed on shares of foreign corporations by Ala. Code § 40-11-1(9) (1975).

calculus. *See* note 8, *supra*; App. 23a-24a. The decision by the court below, therefore, cannot be squared with this Court's requirement that "when the account is made up, the stranger from afar is subject to no greater burdens . . . than the dweller within the gates." *Henneford*, 300 U.S. at 584.

The Complementary Tax Doctrine analysis advanced by the court below seriously jeopardizes the Commerce Clause protections that this Court has erected against discriminatory tax levies. If the Alabama decision stands, States will be invited to justify their imposition of blatantly discriminatory taxes merely by identifying some other levy in the State's tax structure that applies predominantly to in-state taxpayers without the necessity of demonstrating that these levies in design or effect eliminate the underlying discrimination. Furthermore, as the Court has recently reminded us, "'implementation of a rule of law that a tax is nondiscriminatory because other taxes of at least the same magnitude are imposed by the taxing State on other taxpayers would plunge the Court into the morass of weighing comparative tax burdens.'" *American Trucking Associations, Inc.* v. *Scheiner*, 483 U.S. 266, 289 (1987) (citation omitted). In short, because it flies in the face of this Court's precedents and sends a dangerous message to other courts, Alabama's misguided reading of this Court's Complementary Tax Doctrine should not go uncorrected.

II. COURTS SHOULD NOT BE PERMITTED TO EVISCERATE THE EQUAL PROTECTION CLAUSE BY RELYING ON OUTDATED PURPOSES OR BY SPECULATIVELY CREATING NEW PURPOSES TO LEGITIMIZE DISCRIMINATORY TAXES.

In equal protection cases, this Court has tolerated allegedly discriminatory tax classifications when the chal-

lenged discrimination is rationally related to achievement of a legitimate state purpose. *Western and Southern Life Ins. Co.* v. *State Bd. of Equalization*, 451 U.S. 648 (1981). Thus, when a tax is challenged under the Equal Protection Clause, the determination of possible purposes for the alleged discrimination and whether those purposes are legitimate are often principal issues.

In this case, however, all of the parties, as well as the court below, acknowledge that the legislature's purpose in adopting the different domestic and foreign franchise tax bases was to *avoid* the discrimination against foreign corporations that doomed the predecessor to the foreign franchise tax in *Southern Ry.* v. *Greene*, 216 U.S. 400 (1910). *See Louisville & N.R.R.* v. *State*, 201 Ala. 317, 78 So. 93 (1918), *error dismissed*, 248 U.S. 533 (1918).

Because the actual purpose of the tax is to avoid discrimination, speculation as to other purposes that might support discrimination is not permitted. *Minnesota* v. *Clover Leaf Creamery Co.*, 449 U.S. 456, 463 n.7 (1981) ("In equal protection analysis, this Court will assume that the objectives articulated by the legislature are actual purposes of the statute, unless an examination of the circumstances forces us to conclude that they 'could not have been a goal of the legislation'") (citation omitted); *Kassel* v. *Consolidated Freightways Corp.*, 450 U.S. 662, 681-82 (1981) (Brennan, J., concurring).

Furthermore, the State advanced no other state purposes to support discrimination in response to Reynolds' interrogatories and only one—ease of administration of tax itself—at any stage of the proceedings below. Both of the lower state courts specifically held that there is no state purpose supporting the discrimination. Yet, the Supreme Court of Alabama, on its own initiative, con-

ceived of three previously-unidentified purposes. By divining purposes in the face of the actual purpose of the tax, the court below clearly erred. *Minnesota* v. *Clover Leaf Creamery Co., supra.*

Although less rigorous than the Commerce Clause, the Equal Protection Clause also provides important protections against arbitrary discrimination. If the States are allowed to uphold discriminatory taxes by dreaming up unsubstantiated state purposes this protection too will be rendered illusory.

III. THE DECISION IN THIS CASE HAS FAR-REACHING IMPLICATIONS.

The effects of the decision by the court below are not limited to the thousands of out-of-state corporations doing business in Alabama. At least eight other States impose taxes or fees which, at first blush at least, facially discriminate against foreign corporations or interstate transactions.[10] Under the strict Commerce Clause standards

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[10] Georgia: Shareholders of foreign, but not domestic, corporations subject to intangibles tax on their shares (Ga. Code Ann. § 48-6-22 (1981)); Kentucky: Corporations with commercial domicile in Kentucky permitted to deduct book value of its investment in subsidiaries, corporations domiciled outside Kentucky not allowed this deduction (Ky. Rev. Stat. Ann. §§ 136.070-.071 (1983)); Massachusetts: Interest paid to residents by out-of-state banks taxed at 10%, interest paid by in-state banks at 5% (Mass. Gen. L. c. 62, ss 2(b), 4 (1932)); Minnesota: Foreign corporations subject to annual report fee of $15 per $100,000 of Minnesota taxable income, domestics not subject (Minn. Stat. § 303.14 (1951)); Nebraska: Foreign corporations subject to franchise tax at double the domestic rate and subject to higher maximum tax (Neb. Rev. Stat. §§ 21-303, 21-306 (1943)); Texas: Foreign corporations required to deposit $600 when applying for certificate of authority; domestics required to deposit $100 when applying for charter (Tex. Tax Code Ann. §§ 171.155-.156 (1982));

heretofore applied by this Court, these taxes are constitutionally suspect. If state courts are permitted to condone discrimination against interstate commerce because it is not "invidious," or because it was not intended, or because it is "incidental," or because it evolved due to changing circumstances, or because the State can point to some unrelated tax and call it "complementary," or because the State can dream up some state purpose for discriminating against out-of-state interests, nothing will be left of the protection against discrimination afforded by the Commerce Clause.

Indeed, this Court's Commerce Clause decisions recognize that state legislatures understandably respond to constituent pressures and regularly act to protect the parochial interests within their States. Because out-of-state businesses generally cannot exert countervailing pressures, state legislatures often enact legislation that discriminates in favor of local businesses at the expense of out-of-state businesses. This Court, therefore, consistently has recognized the need for judicial vigilance in enforcing the Commerce Clause. *See e.g.*, *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 615 (1981); *Best & Co.* v. *Maxwell*, 311 U.S. 454, 455-56 (1940). Because judicial review under the Commerce Clause "rests on the premises that unaccountable power is to be carefully scrutinized and that legislators are accountable

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West Virginia: Foreign corporations subject to certificate of authority fee ranging from $250 to $4,375, domestic corporations subject to organization fee ranging from $20 to $500 (W. Va. Code §§ 11-12-78, 80 (1931)); Wyoming: Foreign corporations subject to initial tax of 0.1% of assets located in Wyoming when certificate of authority is applied for, domestic corporations subject to initial tax of 0.05% of par value when articles of association are filed (Wyo. Stat. § 17-1-901 (1977)).

only to those who have the power to vote them out of office, it is inevitable that this approach counsels frequent and probing judicial intervention . . . ." L. Tribe, *American Constitutional Law* § 6-5 at 411 (2d ed. 1988).

Left uncorrected, the decision of the Alabama Supreme Court will only encourage legislatures in Alabama and other States to balance their budgets disproportionately on the backs of out-of-state business. Moreover, state courts will be encouraged to uphold the discriminatory taxes, with some realistic hope of surviving the *certiorari* lottery. Reynolds, therefore, respectfully requests this Court to grant this petition in order to reaffirm the important protections against discrimination under the Commerce Clause and the Equal Protection Clause.[11]

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[11] Although the Alabama Supreme Court did not reach the remedy issue, the lower courts avoided ordering refunds by applying their decisions prospectively, citing this Court's decision in *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971). Reynolds believes the use of prospective application to deprive a taxpayer of relief from payment of the discriminatory tax in itself deprives the taxpayer of its rights under the Commerce Clause and the Equal Protection Clause, particularly where the taxpayer has complied with the applicable state refund statute.

CONCLUSION

For the foregoing reasons, this Court should issue a writ of certiorari to review the judgment of the Supreme Court of Alabama, reverse the judgment and remand the case for further proceedings by the court below to determine the remedy to which petitioner is entitled.

Respectfully submitted,

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